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THE ROLE OF SOUTH MULTILATERAL INSTITUTIONS IN INDUSTRIAL FINANCE

Patterns, Problems and Perspectives

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In the course of the work on major sectoral studies carried out by the UNIDO Division for Industrial Studies, several working papers are produced by the secretariat and by outside experts. Selected papers that are believed to be of interest to a wider audience are presented in the Sectoral Working Papers series. These papers are more exploratory and tentative than the sectoral studies. They are therefore subject to revision and modification before being incorporated into the sectoral studies.

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Preface

This document is one of several studies prepared by the Sectoral Studies Branch, Division for Industrial Studies, as a contribution to the preparation for the Fourth General Conference of UNIDO. They were used as an input to the main background paper for agenda item 5(c) of this Conference, "Mobilization of Financial Resources for Industrial Development".

Other titles include: "Proposals for reform of the international financial system: Implication for industrial financing", "Types of finance for industry" and "Exchange of information among developing countries' banks to facilitate industrialization".

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Part I. Summary of results

A. Main problem areas in providing industrial finance

Development finance planned and provided by multilateral institutions in the South is a recent phenomenon in industrial finance. The following groups of financial institutions are involved in developing countries:

(i) Regional development banks, established for the most part in the 1960s;

(ii) OPEC and Arab development funds, established in the 1970s;

(iii) International Arab commercial banks, established or operational in developing countries since the mid-1970s; and

(iv) Islamic financial institutions, established and operational since the late 1970s or early 1980s.

Mandates and operational policies of these institutions differ considerably. One thing, however, is common to all of them: their track record in industrial finance is modest. This is surprising because in all economic development strategies the industrial sector plays a leading role in the growth process. An analysis of the sectoral distribution of project lending by the above-mentioned groups of institutions indicates that the aggregate maximum amount allocated to industry was about 20 per cent. Minimum allocation was below 5 per cent in the case of development-oriented institutions, or the project-lending activities were too recent to provide statistically valid information. The latter applies particularly to the commercial Islamic finance institutions. For example, the Asian Development Bank allocated between 15 per cent and 25 per cent to industry. The African Development Bank provided in fiscal year 1981 about 30 per cent. In the same period, the Inter-American Development Bank provided only 4.3 per cent. The

aggregate sectoral distribution of all OPEC aid agencies for industry was 17 per cent, of which the Saudi Fund provided 8.5 per cent and the Abu Dhabi Fund provided 33 per cent.

The various institutions have different reasons for their sectoral preferences:

(a) In the case of regional development banks, statutes stipulate regional integration as a priority. For this, infrastructure is more suitable than industry. Past activities have shown a preference for agriculture and energy as well. This followed the priorities of the governments of the recipient countries and was backed up by well-prepared feasibility studies which made these projects attractive for the banks.

(b) Among the OPEC and Arab development funds and banks, only the Abu Dhabi Fund and the Islamic Development Bank committed substantial portions of their project lending to industry. OPEC/Arab aid agencies in general suffer from inadequate project identification and appraisal capability, particularly for the industrial sector. In the past, co-financing was their main activity in project lending, whereby project generation was done by their co-financing partners.

(c) Arab international commercial banks have a preference for liquidity and security. This has resulted in their placing large parts of their funds in the Euromarket. They have so far only taken tentative steps towards longer-term commitments in the South, outside the Arab region and Islamic countries. This move requires incentives from the host countries to become a permanent feature.

(d) Islamic financial institutions are a recent phenomenon, with the exception of the Islamic Development Bank, established in 1976, which occupies a special position within this group. Due to their interest-free structure, they had to develop special Islamic financial instruments which make co-operation with other banking systems difficult. So far, they have neither the capability nor

the experience for adequate project generation, identification or appraisal in the industrial sector. The support provided by the Islamic Development Bank for industry in the past (about 37 per cent) may help the commercial Islamic financial institutions to develop this strategy in the near future.

Summing up the major constraints of finance institutions of the South, it has to be reiterated that the problems of industrialization are not identical in the various regions and countries. According to Arab economists, the two major problem areas for industrial development of the entire Arab region are (i) the lack of identified investment opportunities, feasibility studies and project preparation capability and (ii) the small size of the Arab market, which requires the establishment of joint Arab projects, especially for high technology and capital-intensive industrial projects. Development finance institutions have to assume roles of varying intensity, depending upon the level of economic development. Their role in preparing and financing industrial projects differs from Bangladesh to Brazil, from Taiwan to Togo, from Senegal to Singapore, to name only a few.

The preponderance of international Arab institutions within multilateral aid agencies and commercial banks in the South reflects the fact that, only after the emergence of OPEC surplus capital in unprecedented amounts was it possible for a group of developing countries to accumulate adequate capital to warrant the establishment of financial institutions with inter-regional impact.

B. Possible solutions: What can be done in the 1980s

While all traditional sources of external finance for developing countries, such as official development assistance (ODA) flows from Western and OPEC and Arab sources, general purpose commercial lending from Western and Arab banks, direct investments and export credits have recently exhibited a downward trend, Arab international commercial banks and Islamic financial institutions are just entering the picture as possible new sources for project lending.

Industrial finance is scarce. However, industry in developing countries needs new impulses to ensure growth and employment. Against this background,

the institutions in the South could have an important role in mobilizing additional funds and ensuring their effective use in the industrial sector. The following strategies appear to be feasible for the various groups of banks:

(a) Regional development banks can only increase their level of lending if their ordinary capital resources as well as their concessionary resources are augmented. Such negotiations are on the way in the case of all three regional banks. These agencies could also become instrumental in increasing non-concessional flows to developing countries, particularly for industrial finance. The following possibilities should be investigated:[1/]

- The donor agency as a financial intermediary: This is only feasible for institutions which are empowered by their statutes to borrow from the international capital market. Some institutions which have this possibility have yet to play this role. In the near future, financial intermediation is likely to become more prominent because direct and bilateral access to capital markets will become more expensive, if not more difficult, for developing countries;

- The donor-agency as a co-lender with commercial sources: Compared with commercial banks, donor agencies are in the privileged position of having greater access to reliable information on the potential borrowers, capacity for project appraisal, acceptability by recipient governments, inter alia. Donor agencies could use such advantages more systematically for attracting greater volumes of non-concessional funds in the co-financing of industrial projects;

- The donor agency as catalyst in foreign direct investment: By providing equity participation together with loans for projects appraised by it, the public donor agency can directly, or through

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1/ See the "Summary Report of the Meeting of OPEC/Arab-DAC Donor Agencies with participation of Multilateral Financial Institutions and Commercial Banks", held in Vienna, May 30 and 31, 1983, at the OPEC Fund.

the intermediation of national development finance institutions, play an important role in attracting additional risk capital from other sources;

- The donor agency as an advisor and source of technical assistance: The experience of donor agencies should be made available to interested developing countries by putting together financial packages attractive to foreign investors. This may include information on foreign sources of finance, assistance in tapping international markets, revising investment codes, improving the efficiency of local institutions, instruments, legislation, etc.

- The donor agency as a promotor of investment companies: Public development finance institutions could take the lead in sponsoring the establishment of investment banks.

(b) OPEC/Arab development funds and banks benefited from substantial capital increases in 1980 and 1981. Given the present level of annual oil revenues, these finance institutions in developing countries cannot expect capital increases in the near future. However, their developmental impact could be further strengthened by extending their well-established co-ordination activities in the field of industry. Another possibility could be to strengthen and to co-operate more with national development finance institutions, especially those catering to the industrial sector. Furthermore, all the possibilities available to the regional development banks in mobilizing non-concessional funds for industry could also be pursued by OPEC/Arab funds. International Arab commercial banks and investment companies could be natural partners.

(c) International Arab commercial banks have only limited project-lending capabilities and thus limited project identification and appraisal capacities. Therefore, they could use to good advantage the "umbrella" function of both Arab and Western aid agencies. Project financing (particularly industry) appears to be a

better business proposition than providing general balance-of-payments support loans. Furthermore, they could use the information on potential investment possibilities, particularly in growth areas outside the Arab and Islamic countries.

(d) Islamic financial institutions concentrated in their formative years on mobilizing profitable investment opportunities. Project appraisal and follow-up will be the major challenges to these institutions in the future. The possibility to co-operate with other banking systems, e.g. to provide working capital and other short-term requirements besides long-term lending, is unresolved. Operating policies and business styles of Islamic financial institutions are often conceived and formulated without fully acknowledging the fact that a well-entrenched Western banking system is already in existence in all of the countries in which they are located. Due consideration of this fact may give a new impetus to Islamic banking and its potential impact on industrial finance in the 1980s.

Part II. Background and major issues

A. International conditions for developing countries

The present situation for developing countries is gloomy: foreign debts now exceed $U.S.800 billion. During 1982 more than one-half of the decline of $130 billion in world trade was borne by developing countries, although they accounted for only one fourth of such trade. As a result, developing countries had to cut imports by $85 billion in the last two years. This is also due to a decline in export earnings, increasing debt service payments ($37 billion) and a decline in international borrowing ($1) billion) over the same period.

According to a recent report of the Bank of International Settlement (BIS),[2/] international bank lending appears to continue to slow down much more sharply in 1983 than had been anticipated. For instance, the International Monetary Fund (IMF) has a working hypothesis that net increase in bank lending to non-oil developing countries will increase 7 per cent p.a., down from a 20 per cent increase before the debt crisis.

If lending, as now foreseeable, fails the IMF target, the debt crisis could deepen. The lending decline portends for the future an even more radical cut in imports of developing countries and thus of their industrialization potential.

B. Industry in development

In all economic development strategies the industrial sector plays a leading role in the growth process. Together with agriculture, industry forms the backbone of productive activities in the economy of countries in the South. The global structural changes the world economy has to face will more significantly affect industry. Industrialization, however, is necessary to raise standards of living and to develop a sound economic basis--pre-condition

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2/ Carl Gewirtz, "BIS Data Raises Concern About the Lag in Lending", International Herald Tribune, 19 July, 1983.

for the New International Economic Order. Industrialization of the South has to be pursued because of the tendency of commodity terms of trade to deteriorate against manufactured goods, as well as the necessity to create more employment opportunities and to reduce the vulnerability to socio-economic development in the South.

C. The emergence of finance institutions in the South

Given the limited savings capacity of the majority of developing countries, the availability of external finance has been essential for their growth and development. Initially, the World Bank group and Development Assistance Committee's (DAC) aid agencies of the OECD countries provided the bulk of this finance. South multilateral institutions operating in specific regions or group of countries emerged later in the South. First, the three regional development banks were established for the most part in the 1960s, followed by the Arab and OPEC development funds and banks in the 1970s.

With the changes in the patterns of international financial flows since the mid-1970s, Western commercial banks have become more involved in channelling funds into developing countries, primarily into higher-income nations that constitute the newly industrialized countries (NICs), providing balance-of-payments support and general-purpose loans. With the advent of the 1980s, international Arab commercial banks and, to a lesser extent, Islamic financial institutions entered into the picture, thus providing additional sources of finance from and for the South.

The first task of multilateral institutions in the South was to create the conditions for developing countries to participate to a larger extent in the global boom in the 1960s and early 1970s. The financing of infrastructure in the largest sense dominated the picture during the formative years of these development finance institutions. Certain changes in trends and orientation occurred over the following years, due to the level of economic development attained by the beneficiary countries and regions, as well as the shift in the international situation.

Agriculture and energy became important priority sectors for many of these institutions in the 1970s. By and large, aid agencies followed the priorities stipulated by the governments in the beneficiary countries. It seems, however, that project preparation in developing countries had concentrated on large units in infrastructure, energy, etc. with high foreign exchange components to the detriment of medium-sized industrial investment opportunities.

D. The spectrum of industrial finance

Many questions arise why the industrial sector - so important for stimulating economic growth and for creating employment - appears so far relatively neglected by development agencies in the South. There is yet a definition to be brought forward by providers of external finance on the exact content of industrial finance. Some institutions apply it only to manufacturing, others include the extractive industries (mining) and even energy. In some cases, lines of credits to national development finance institutions for sub-lending to medium and small industrial enterprises are included. In the case of Islamic financial institutions, "lines of equity" follow a similar concept. Furthermore, specific Islamic financial instruments were developed, particularly suitable for industrial finance.

In the largest sense, industrial finance could include, for example, technical assistance and training components as well as all activities promoting industrial enterprise. By and large, it can be stipulated that, more recently established institutions focus only on the financing of the industrial plant as such (hardware industrial finance), whereas institutions with more operational experience and a track record of many projects assisted tend to cover the entire project cycle, from project generation through feasibility and appraisal studies to the ultimate follow-up and monitoring, which could eventually lead to the systematic generation of related projects (software industrial finance).

Likewise, the definition of a "good industrial project" is not uniform, if not non-existent. It depends upon the mandate and the operating policy of the institution providing the funds. A development-oriented bank will apply

different criteria than a commercial bank; the former being interested in the overall developmental and socio-economic impact, including employment creation, transfer of technology, training effects, etc., whereas the latter is basically interested in security of principal, high yield and quick cash-generating capability.

Another major issue in industrial finance is the problem of co-ordination between term-lending institutions and commercial banks. The provision of short-term credit and long-term finance without appropriate linkage between them tends to reduce the effective use of each type of financial support.

E. South-South financial co-operation

Recently project co-financing gained new impetus, whereby different providers of funds join in financing a project. Due to the fact that commercial banks are interested in getting more involved in development finance, industrial projects are now more eligible for mixed financial packages. This possibility has yet to be explored in a systematic way. Presently, this approach is being tested and expanded by major development finance institutions in the South, following the lead of the World Bank group.

It may involve in the near future multilateral OPEC/Arab development funds, international Arab commercial banks to a large extent, both as direct investors in developing countries, as well as partners in co-lending operations between aid agencies and commercial sources of funds.

Besides stepped-up co-financing activities, various other methods and approaches were discussed in international fora for increasing the resource flows for productive uses (in the industrial sector) in developing countries. Financial institutions in the South may be in a better position than occidental finance institutions to assess the perceived development objectives of developing countries and to link them to realistic implementation.

If stepped up finance for industrial development should be achieved, a strengthened international financial system under increased control and influences of developing countries is a prerequisite for a revived growth in

the South. In this context, multilateral development finance agencies in the developing countries have a special role to play, as well as the international Arab and Islamic commercial banks. Their role would be twofold: to be fund providers for productive uses and to function as catalysts for other external sources under an improved bargaining position for the South. This would also facilitate better financial and industrial co-operation between developing countries in evolving new and innovative finance modalities, benefitting the recipients in the developing countries without inflicting disincentives on the fund providers from the North or the South.

Given the present problems in international finance in general, and in industrial finance in particular, it is time to assess the scope and extent of the contribution to industrialization of the various groups of multilateral institutions in the South. Relevant data and information are scattered, scarce and often soft. A first attempt to deal with the subject matter will of course raise many questions without initially being able to provide comprehensive and comparable answers. Therefore, this document could serve as a systematic framework for future research by defining the major issues, presenting the information so far readily available and indicating the main gaps and problem areas.

The ultimate purpose should be to explore practical and feasible ways for increasing the total flow of industrial finance (in balance with the corresponding financial needs of other economic activities) and for making the most efficient use of it.[3/] Both objectives have to reconcile the interests of the various fund-providers with those of the recipient countries in order to become and remain a permanent feature in the 1980s.

3/ See World Bank, World Development Report, 1983, Part II: "The search of efficiency" (Washington D.C.)

Part III. Groups of finance institutions in the South

A. Regional development banks

(i) Objectives and scope of activities.

Regional development banks were the first institutions in the South with the mandate to promote growth and development exclusively in their respective continents. They were the first finance agencies to define and implement development policies as conceived and formulated by developing countries. This holds true although their structure was strongly influenced by the World Bank model. The very motive for their establishment was the desire to find an alternative to the World Bank group, more directly under the control of the regional developing countries.

Three main reasons were instrumental for the establishment of the regional development finance institutions in Latin America (1959), Africa (1966) and Asia (1966):[4/]

(a) First, the perceived need to create a regional identity among a group of countries for translating common interests and development aspirations into operational reality. Thus all three development banks give priority to "integration projects" in their statutory objectives;

(b) Secondly, the possibility to mobilize additional external resources from the world financial system. An important step in the pursuit of this objective was the admission to membership of non-regional countries. With the recent decision of the African Development Bank to admit both industrialized and OPEC/Arab countries, all three regional development banks now include non-regional countries among

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4/ See M.A. Loutfi, "The Role of Multilateral Development Finance Institutions of Developing Countries in Support of Economic Co-operation and Integration", Conference document, Third Conference of Development and Commercial Banks from Developing Countries, Ljubljana, Yugoslavia, 6-8 July, 1983, pp. 2 and 3.

their members. This move strengthened their capital base and enhanced their borrowing capacity in the international capital markets;

(c) Thirdly, these aid agencies provided additional region specific services, otherwise not available or not adequately available from the existing aid institutions, in addition to straight financing. This included all types of pre-investment and planning activities, regional surveys for specific sectors, promoting private investment, assistance in the more efficient use of resources, technical assistance and training facilities, expanding trade between member countries, to name a few.

The primary aim of the regional development banks is the economic development of all or some of their members. In all cases, except for that of the African Development Bank-- where the goal of social progress is also specifically stated as a purpose-- all the provisions emphasize the economic aspects.[5/] Whether and to what extent this is concentrated on infrastructure, agriculture, industry or other areas, is left to the discretion of the institution within its statutes.

Activities include project lending, equity participation, technical assistance, as well as all services to member countries which may enhance the stated purpose of the respective institution. The African Development Bank is empowered only under certain conditions to make equity investments and to extend guarantees. The maximum percentage equity holdings in any one undertaking is fixed from time to time by the Board of Governors. The Asian Development Bank has provided equity capital only since 1983 (up to 25 per cent) for development projects, whereby industry is considered to be the most suitable sector for this new orientation. None of the regional development banks grant special conditions for industrial finance. The normal operating policies of the three institutions are outlined below.

5/ John Syz, International Development Banks, New York, 1974, p.24.

(ii) Operating policies, terms and conditions

The operations of the Inter-American Development Bank are divided into:

- Ordinary operations, financed from the Bank's ordinary capital resources (loans are extended at interest rates closely related to the IDB's borrowing);

- Inter-regional operations, financed from the Bank's inter-regional resources from which loans are made on identical terms to those from the ordinary capital;

- Special operations, financed from the Special Fund with comparatively softer conditions than ordinary loans.

Since 1972, the IDB had pursued a policy of preferential treatment for the less-developed developing countries and those with limited access to capital markets. The finance conditions are highly concessional, with 2 per cent interest, maturity up to 40 years including grace periods up to 10 years.

Other funds administered by the IDB include the Venezuelan Trust Fund, established in 1975 for a period of 25 years with resources of $US 500 million. Although the VTF's resources are intended to finance integration projects in less-developed Latin American countries, loans are extended on non-concessional terms: maturities range up to 25 years, including a grace period of 6 years, and interest rates are equal to the IDB rates on ordinary capital operations plus a commitment charge of 1.25 per cent on undisbursed balances and a management charge of 1 per cent of the loan amount.

The African Development Bank (ADB) is authorized to make, participate in or guarantee loans to members, any political subdivision, or any public or private enterprise operating within member countries. The Bank may extend the same form of assistance to international or regional entities concerned with economic development in Africa. Normally, it covers foreign exchange expenditures for development projects. In certain circumstances, the Bank also finances local expenditures.

The maturities of the loans extended by the ADB from its ordinary capital resources range from 10 to 20 years and include grace periods ranging from 2 to 5 years. Pre-investment loans are charged with 10 per cent interest, medium and long-term investment loans with 9 per cent interest.

The Asian Development Bank's (AsDB) lending activities are divided into ordinary operations (financed from ordinary capital resources from the Bank) and special operations (financed from the special fund resources). The eligibility of a developing country for concessional loans is dependent upon the country's economic situation (graduation policy). Furthermore, the AsDB undertakes sector lending, primarily for capital requirements and to help strengthen sector policies of the beneficiary country.

The maturities of the ordinary loans range from 10 to 30 years and include grace periods from 5 to 7 years. For special fund loans, the maturity is 40 years and the grace period 10 years. Eleven per cent interest is charged for ordinary investment loans and a service charge of one per cent for special fund loans.

(iii) Activities in the industrial sector

Since 1961, the IDB had provided industrial finance for expanding, modernizing and diversifying this sector in two distinct, however complementary, forms. Large public and private enterprises may borrow directly to finance major industrial projects involving, for example, iron and steel, agro-industries, chemical and petrochemical plants, metal products, etc. The other form of financial assistance are credit lines to national development finance institutions which in turn provide sub-loans to small and medium industrial enterprise.

By the end of 1981, IDB's industrial lending totalled about US $2.8 billion, including direct loans as well as credit lines to national development banks. This financial support helped to finance projects valued at US $28.7 billion, comprising 93 manufacturing plants and some 11,500 small and medium-sized projects. In fiscal 1981, five industrial projects have been financed by the IDB, representing 4.3 per cent of total lending. The priority sectors are infrastructure (65 per cent) and agriculture (28 per cent).

In addition to providing direct finance to industry, it is the African Development Bank's policy to co-operate with national development finance institutions to support the small and medium industrial sectors. The Bank is very flexible in this respect to suit each individual case: it may examine the possibility of establishing national finance institutions, providing training for the staff, strengthen the management capability, etc. The AsDB's technical advisory services to national and sub-regional development banks is provided on a non-reimbursable basis.

In fiscal 1981, the AfDB allocated 30 per cent of total lending to industry, 25 per cent for infrastructure, 22 per cent for agriculture and 23 per cent for other services.

The Asian Development Bank's industrial loans have been provided for specific projects in the fields of agro-industry, manufacturing industry, non-fuel minerals and development banks catering to the industrial sector. Up to the end of 1981, between 15 per cent and 25 per cent of the Bank's lending was allocated to industry, both in the form of direct lending and through credit lines to national development banks.

The AsDB may also extend industrial programme loans to overcome under-utilization of existing production facilities in high priority sectors. This is often due to the shortage of foreign exchange to import essential equipment, components, spare parts and raw material. Programme lending is limited to 5 per cent of the Bank's anticipated annual lending, and to 10 per cent of the Bank's anticipated lending to a specific country.

In fiscal 1981, the AsDB allocated 42 per cent of its project lending to industry, energy, non-fuel mineral enterprises and development banks; 33 per cent to agriculture and agro-industries and 25 per cent to social infrastructure.

(iv) Major problems and perspectives

The preceding analysis indicated that the regional development banks so far did not consider industry among their priority sectors. Regional integration was the statutory priority attempted by means of infrastructure projects.

Given that regional development banks follow, by and large, the priorities of the recipient governments, namely, infrastructure, agriculture, energy, etc., it appears that industrial finance was considered not to be the most urgent need. In some cases and countries, other sources could be made available for this purpose. The statutory and policy priorities of these institutions have been infrastructure, including transport and communication, agriculture and energy. This orientation was often congruent with that of recipient countries which backed such projects with well-prepared feasibility studies. This made these projects attractive for the regional development banks because they permitted quick implementation and saved additional expenses for assessing their viability.

The present serious international situation may change the perceived priorities with respect to industry. Only this sector can help restore growth and generate employment opportunities in developing countries on a large scale. However, the limited concessional resources generally available and the difficult negotiations under way to increase the capital base of multilateral development finance institutions will require additional commercial flows of funds rather than a shift of priorities to generate more industrial finance.

In this context, the move of all three regional development banks to increase or to initiate co-financing with commercial sources of funds as well as to engage in equity capital operations will benefit primarily the industrial sector. Of the regional banks, the IDB has the greatest experience in co-financing operations. The Bank has developed complementary financing schemes, designed not only to increase its lending capacity, but to reduce the risk factor in credit operations, particularly in industry.6/

IDB has just completed its largest co-financing operation ever with Chile (early 1983), entailing a $100 million loan for IDB and $80 million from a syndicate of commercial banks.

6/ Julio Heurtematte, "IDB's Support to Latin America's Industrial Sector", document presented at the UNIDO Symposium on Financial of Industry Projects, Vienna, May 1982.

Co-financing with the private sector, especially for industry, will take on greater importance in the coming years: it relieves pressure on aid agencies which can divert additional funds to projects, sectors and countries in need of concessional terms. However, it should not be made into a condition for aid agencies' lending; nor should quantitative targets be set for co-financing. Given the realities of the market place, there are inherent difficulties in targeting co-financing operations by countries and sectors because they could distort the selection of "good industrial projects" suitable for this purpose.

IDB recently initiated a scheme, the "additional external resource programme," to attract not only commercial loan finance, but equity as well, primarily for industrial projects. IDB sees the following advantages in providing equity:

- It will improve the leverage of the project's capital structure;
- It will give small and medium private investors access to this type of equity;
- It will provide "moral security" for joining commercial banks due to the regional bank's first-hand knowledge of the region.

Like other regional development banks, IDB feels that mechanisms for channeling venture capital into developing countries are not yet on a scale to meet demand.

The AfDB is also aiming to stimulate co-financing despite its limited experience in this field. Staff of the AfDB has visited the World Bank group and other regional development banks to identify the optimum formula for Africa: co-financing with co-participation resembling the World Bank's "B" contract[7/], i.e. participation in the syndication for the financing of specific projects, while assuming the role of lead manager and project manager

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7/ See Annex III, The World Bank's Co-financing Programme with Commercial Banks.

at the same time. This appeared to be necessary, given the difficulties experienced by commercial banks in the region which required strict guarantees. In this respect, the AfDB would follow the IMF guidelines which envisage such guarantees for the entire duration of the contracts (i.e. for 7 to 12 years), in addition to the lengthening of grace periods and priority reimbursement to commercial banks. Since cost-overruns were more prevalent in Africa than elsewhere, there was a need for a two-tiered guarantee system (for project execution and reimbursement) to cover them.

The AsDB at present is making a conscious effort to stimulate co-financing with commercial banks. This strategy is not only conceived to offset shortages, but it is also applied as a means to provide much needed capital inflows to developing countries, together with other means such as bond issues, syndicated loans, export trade, etc. The AsDB is also investigating the possibility of an equity-financing plan for Asia. At a symposium on the subject of co-financing and direct investment in 1982, about 300 prominent commercial bankers all over the world were invited, in addition to the potential recipients.

The experts stressed that the AsDB's equity scheme should be different from that of the IFC. It should not diminish AsDB's loan finance activities, but could focus on large enterprises while also serving small private investors, preferably in industry, and might come to the aid of temporarily ailing projects. The AsDB has recently started to invite eligible entities to apply for the Bank's equity scheme.

B. OPEC/Arab development funds and banks

(i) The phenomenon and impact of OPEC and Arab aid[8/]

If any event in development finance characterized the decade of the 1970s, it was the emergence of OPEC and Arab development funds and banks. It was the first time that development assistance was extended exclusively by

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8/ See Antonio R. Parra, "The Role of Middle Eastern Financial Institutions, draft document to be published by Euromoney, fall 1983, as a chapter in a revised edition of International Financial Law.

developing countries on an institutionalized and co-ordinated basis. Already in 1973, OPEC countries had replaced the countries belonging to the Council for Mutual Economic Assistance (CMEA) as the second largest donor group, with a share of 16 per cent in world official development assistance flows.[9/] Some Arab oil-exporting countries had provided financial assistance to poor Arab countries even before that year, basically to finance health and educational facilities, but the amounts were rather modest compared to present aid performance.

Today several OPEC member states are ranked among the ten major world donor countries, not only as a percentage of GNP, but also in terms of absolute aid amounts.[10/] Not only the quantity, but also the quality of OPEC/Arab assistance and thus the overall development impact was high. Such aid is untied to procurement of donor agencies. It is, by and large, not subject to restrictions such as the financing of only the foreign exchange component of projects. A high percentage of OPEC assistance was in pure grants (56 per cent) and 65 per cent over the period 1973 to 1981. The loan component of the assistance contained a grant element of 78 per cent.

The scope and pattern of distribution of Arab aid has undergone changes since its inception. In 1973, Arab assistance was directed to 13 countries; today 93 countries are benefitting. The order of priority was, and still is, Arab countries, other Islamic countries, and the rest of the developing countries.

The tremendous assistance effort has to be assessed in the context of the economic level of development of Arab countries. No nation has yet developed a diversified industrial base, an advanced agricultural sector or, with the possible exception of a few countries, any major export other than petroleum. At present, even the favourable financial position once held by the low-absorbing countries has been eroded. OPEC countries as a group have become net borrowers on financial markets.

9/ OECD, "Aid From OPEC Countries" (Paris, 1983), p.14.

10/ OPEC Fund, "OPEC Aid and OPEC Aid Institutions, A profile" (Vienna, 1982).

Until the emergence of OPEC and Arab aid agencies, development assistance was a one-way association between industrialized nations providing financial support but imposing their terms, on the one side and, on the other, poor countries without influence in shaping international economic relations. With the appearance in the South of new major donors and financiers, a new type of relationship is taking form, affecting North-South, South-South and North-North relations. In this context, the influence of OPEC/Arab aid agencies goes far beyond their financial contribution to the development of recipient developing countries, be it industry or other economic sectors.

(ii) Objectives and scope of activities

The larger part of the assistance of OPEC countries was mainly direct government-to-government transactions. A considerable part, however, has been channelled through specialized national and multilateral aid agencies, the former established by Kuwait (in 1961), Saudi Arabia, the United Arab Emirates, Iraq, the Libyan Arab Jamahiriya and Venezuela. Multilateral institutions include the OPEC Fund for International Development, the Islamic Development Bank, the Banque Arabe pour le Developpement en Afrique (BADEA) and the Arab Fund for Economic and Social Development (AFESD).11/

OPEC countries contributed 85 per cent of the capital of the three latter institutions with: in the case of the IsDB with US $1.7 billion or 79 per cent, in the case of BADEA with US $695 million or 94 per cent and in the case of the AFESD US $2.1 billion, or 82 per cent.

The main objectives of the OPEC/Arab aid agencies are well reflected in Article 1 of the Charter of the Kuwait Fund for Arab Economic Development (KFAED): "...to assist Arab states in developing their economies and in particular to provide such states with loans for the implementation of their development programme." Until 1974, Arab aid was only by the Arabs and for the Arabs. Since that date, the established Arab aid agencies became authorized to expand their geographic coverage, and institutions founded later got a larger geographic mandate from the very outset.

11/ See Annex I: Major OPEC/Arab Banks and Funds.

In addition to project lending - the main form of assistance - the OPEC and Arab funds may provide grants, technical assistance, guarantees, etc. The revised KFAED Charter, promulgated in March 1981, empowered the institution to contribute to the capital stock of developing countries corporate bodies (development projects), as well as to the resources of international and foreign development institutions.[12/] The first function - equity financing - can also be provided by the Abu Dhabi Fund and the Islamic Development Bank. The concept and modalities of Islamic banking will be presented in detail in the chapter on Islamic financial institutions. The latter power-making contributions to eligible international agencies reflects the influence of the Agreement Establishing the OPEC Fund, which similarly empowers that agency.[13/] The OPEC Fund also provides balance-of-payments support to developing countries.

OPEC/Arab aid institutions follow to a large extent World Bank policies, practices and procedures in providing project-oriented assistance.[14/] The appraisal reports have, by and large, the format of World Bank documents. This facilitates the large number of co-financing activities both with other OPEC/Arab agencies and multilateral and bilateral Western aid agencies.

These institutions also developed innovative approaches in their formative years.[15/] Flexibility and speed in responding to the needs of beneficiaries have been complemented with an awareness of the requirement for new institutional practices. One of the most outstanding achievements of OPEC and Arab institutions is their coordination efforts.[16/] This has entailed the harmonization of operational procedures, the exchange of information on new projects and an increase in joint appraisal, thus a higher developmental impact in a shorter time.

12/ Kuwait Fund Charter, as revised in March 1981, Article 17.

13/ See Article 2 of the Agreement regarding the contribution to IFAD.

14/ Traute Scharf, "Trilateral Cooperation, Arab Development Funds and Banks, OECD" (Paris, 1978), p.58.

15/ See Ibrahim Shihata et. al., The OPEC Fund for International Development, The Formative Years (London, 1983).

16/ The Arab Fund serves as technical secretariat for co-ordination among Arab/OPEC funds.

(iii) Terms and conditions of industrial finance

The national Arab development funds provided financial assistance on relatively soft terms. The highest rate of concessionality was that of the Saudi Fund whose grant element of lending during the last 5 years averaged 51 per cent. The corresponding averages for the Kuwait Fund, the Iraqi Fund and the Abu Dhabi Fund were 46 per cent, 45 per cent and 38 per cent, respectively.

Depending on the type of the projects and the level of development of the beneficiary country, the Kuwait Fund's loans are extended at interest rates of 0.5 per cent service charge. Maturities vary between 9-and-one-half years and 50 years and include grace periods from 2 years to 11 years. Generally, industrial projects tend to be financed at harder terms - the upper range of the above-indicated margins is more applicable - than agriculture or infrastructure projects.

Again depending on the type of the project, interest rates of the Abu Dhabi Fund range from 2 per cent to 6 per cent, while maturities are between 6 years and 25 years, with grace periods varying between 1 and 7 years. In addition, the Fund levies a 0.5 per cent service charge on its loans.

The regional OPEC and Arab aid agencies also provide their assistance at a high degree of conditionality. The OPEC Fund for International Development provides terms with a grant element of 56 per cent, BADEA and the Arab Fund with 43 per cent and 34 per cent, respectively.

A significant proportion of the assistance of regional OPEC/Arab aid institutions has been provided to developing countries. Over the period 1976 to 1981, this proportion was more than 40 per cent, with the highest share, 55 per cent, contributed by the BADEA. The allocation to the most seriously affected group of countries which overlap with the former group, including additional low-income countries, averaged 65 per cent, with the highest allocation to this group, 75 per cent, contributed by the OPEC Fund.

(iv) Sectoral allocation in project-lending

Within the national Arab aid agencies, there were considerable differences among the institutions with respect to sectoral allocation. Thus, the Abu Dhabi Fund focussed with more than 30 per cent more on the manufacturing industry than did other institutions. It shared this tendency with the Islamic Development Bank which allocated in total more than 35 per cent to industry. In contrast to that policy, the Kuwait Fund and the Saudi Fund for Development give relatively more importance to agriculture (about 20 per cent) than the other institutions within this group.17/

The aggregate sectoral allocation for the national Arab aid agencies, over the period 1976 to 1981, was as follows: $4.5 billion or 65 per cent for infrastructure (including transport and power projects), $830 million or 12 per cent for manufacturing and mining, $725 million or 10 per cent for agriculture and livestock and another $700 million for other projects.

The operations of the regional OPEC and Arab development finance institutions also emphasize infrastructure. The share of this sector represents 40 per cent (of a total of $3.9billion), whereby electricity, gas and water projects received nearly half of the commitments. Most of the energy projects are for primary energy (hydro-electric power).

Assistance to the directly productive activities in agriculture and manufacturing and mining was relatively small, about 10 per cent, 6.5 per cent and 6 per cent, respectively. The variation of sectoral emphasis among the regional institutions was significant. Aside from the relatively high proportion given by all aid agencies to infrastructure, it was the BADEA which gave the most emphasis to the directly productive sectors, with agriculture claiming 20 per cent and manufacturing 11 per cent of its commitments over the period 1976 to 1981.

17/ The Arab Fund, Arab National and Regional Development Institutions, Statement of Financial Operations, Dec. 31, 1981 (Kuwait, 1982), p.11 and 12, Summary of Sectoral Distribution of the Financing Operations by Institution and Region.

Summing up the project-lending performance of all OPEC/Arab aid institutions, 17 per cent of total commitments was provided for manufacturing and mining, 54 per cent for infrastructure (including power, transport, water and sewerage), 15 per cent for agriculture and livestock and 12 per cent for other projects.[18/] In this context it is of interest to note that in Arab beneficiary countries (to which more than 50 per cent of total lending was directed), 19 per cent was allocated to industry. In the case of Asian countries, it was 18 per cent (out of a total lending of 26 per cent); in the case of African countries 11 per cent was allocated to industry.

Similar to the regional development banks, the OPEC/Arab development funds provided industrial finance in two forms: provision of direct lending to large projects and extension of credit lines to national development banks for sub-lending to medium and small industrial enterprises. The amounts given above include the two types of operations.

OPEC/Arab funds co-financed projects not only among themselves, but also with regional and international development finance institutions and bilateral aid agencies from DAC/OECD countries. The number of projects co-financed by these institutions reached nearly 350 by the end of 1981.[19/] The amounts allocated to these projects totalled $22.5 billion. OPEC and Arab countries and institutions contributed one-third of the funds involved. Of the total amount, industry and mining received 25 per cent (the largest portion, 60 per cent, went to infrastructure, while agriculture received 7 per cent). The projects are being carried out in 85 developing countries, of which over one-half are in Africa, one quarter are in Asia, approximately 15 per cent are in Latin America, and the balance is in Oceania.[20/]

(v) Major problems and perspectives

National and regional OPEC/Arab aid agencies constitute a sort of privileged network for developing countries. They not only streamline

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18/ Ibid.

19/ OECD, Working Document, DCD/82, 6 May 1982.

20/ "OPEC Aid and OPEC Aid Institutions, A Profile 2", (OPEC Fund, Vienna, 1982), p.39.

assistance activities, but they also have a high catalytic and leverage effect beyond their financial contribution. These finance institutions in the South have pioneered in co-ordinating their activities among themselves, as well as with international and Western aid agencies. Over the last 5 years, contacts have been intensified at both the planning and policy level and in operational activities. So far, the sectoral emphasis was on infratructure. This corresponded largely to the perceived priorities of the recipient countries in the 1970s. At present, the OPEC/Arab aid agencies could further strengthen their developmental impact by extending their well-established co-ordination activities in the field of industry.

OPEC/Arab development funds benefitted from substantial capital increase in 1980/1981. Given the present level of annual oil revenues, these finance institutions in the South cannot expect capital increases in the near future. Therefore, the strategy to mobilize more industrial finance cannot be limited to using their own funds, but to help in increasing the total fund flows from other sources. In particular, mobilizing non-concessional funds for industry could be pursued by OPEC/Arab aid agencies. International Arab commercial banks and investment companies could be the natural partners.

Another possibility to strengthen the industrial sector could be closer co-operation with national development banks in recipient countries. These institutions have an important liaison function: mobilizing foreign and local funds, on the one side, and identifying investment opportunities, on the other. Multilateral finance institutions in the South can only reach the medium and small industrial sectors through these national finance intermediaries.

Furthermore, the Arab aid agencies may benefit from the geographic experience of national development banks, particulary outside the Arab region, by using their appraisal capacity either immediately or after having strengthened their project-generation capacity.

C. ARAB INTERNATIONAL COMMERCIAL BANKS

(i) Evolution and internationalization of Arab banking

The national and regional development funds described in the preceding chapter constitute the centre of a larger network. The intermediation mechanisms for Arab capital should foster development and growth in developing countries and overcome the resource gap in deficit countries through channels best suited to the economy and developmental possibilities of recipients, e.g. concessional assistance, commercial lending, direct investment, international bond issues, etc. All these channels are part and parcel of a dynamic and changing system and components of a global network aimed at the promotion of economic development. This process should bring about mutual benefits both for the fund-providers and the capital-absorbers.

Significant amounts of Arab capital have been invested in various financial, industrial, commercial and real estate joint-ventures in many developing countries of Africa, Asia and Latin America. The extent and the amounts involved in such flows are not fully recorded. Some rough estimates put the figure for Arab joint ventures with developing countries at about $32 billion.

In this context it is of interest to review the institutional network at the disposal of Arab countries to channel surplus capital into other developing countries at commercial terms.[21/] The start of Arab commercial banking was extremely modest. Up to the early 1960s, these local banks were basically concerned with domestic and trade business. With the independence of the majority of Arab countries during the following decade, national banks

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21/ See Traute Wohlers-Scharf, "Arab and Islamic Banks, New Business Partners for Developing Countries" (OECD, Paris, Sept. 1983).

were established with the objective of assisting the economic development of the new nations.[22/]

With the first major oil price increase in 1973, Arab banking started to develop at a different pace. There was an unprecedented growth in the number and capital structure of Arab financial institutions, some of them including Western partners (e.g. UBAF, BAII, European Arab Bank, etc.) In this context, the objectives of the Arab shareholders were to penetrate the international capital market and to participate in the management of Arab funds, to a certain extent, at the international level.

Since the mid-1970s, inter-Arab joint-banking ventures were established by Gulf States and the Libyan Arab Jamahiriya. Between 1980 and 1981 many Arab institutions received substantial capital injection, e.g. Gulf International Bank (established in 1975), Saudi International Bank (established in 1975), based in London, Libyan Arab Foreign Bank (established in 1971), ABIFT (established in 1975). The largest Arab joint venture bank was founded--the Arab Banking Corporation--with an authorized capital of $1 billion.

At present, the Arab commercial and investment banks appear to be in a position to cater to the financial needs of their own region and to manage to a greater extent the placement and investment of surplus capital at the international level, and in other parts of the developing world.

(ii) Objectives and scope of activities in developing countries

Arab banks became engaged in financing direct productive acitivities only with the establishment in 1960 of national banks assisting in implementing the

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22/ Some of the early established Arab banks belong today to the major institutions in their respective countries, e.g. the National Bank of Egypt (1898), Banque Misr (1920), Bank of Jordan (1930), National commercial Bank of Saudi Arabia (1938), Rafidain Bank of Iraq (1942), etc. Arab banks which promoted national economic development include, inter alia, the Jordan National Bank (1952), the National Bank of Bahrain (1957), the National Bank of Egypt (nationalized in 1960), Qatar National Bank (1965), Commercial Bank of Syria (1967) and National Bank of Yemen (1970).

national development plans. One forerunner was the Banque Misr in Egypt (1920), a commercial-cum-investment bank which also financed industrial enterprises. Later specialized banks supported or took over the task of national banks in financing industry or agriculture. At this stage, the activities were purely domestic.

The first international Arab banks, as well as Arab-occidental banks, were mainly engaged in international trade finance (for stepped-up imports in the Arab region and to assist in financing oil exports) and in Euromarket operations. Syndicated Euroloans were mainly channelled to Latin America and Asia, but also to high-absorbing Arab countries. There was a substantial growth in Arab Euromarket lending by the operations of the inter-Arab joint venture banks. Some of these loans were project-linked for infrastructure, energy, transport, etc.

The Euro-Arab consortium banks--comprising the second generation of Arab consortium shareholders in a predominantly bilateral framework--are encouraging investment in specific areas, including industry in the banks' host countries, e.g. the Arab-Hellenic Bank. The Aresbank is involved in trade financing and attracting Arab capital for Euroloans in Spain. The Saudesbank is interested in real estate for Saudi nationals and finances Spanish oil imports. The Arab-Turkish Bank is issuing international guarantees for Turkish contractors working in the Maghreb and Mashreq.

The Arab Latin-American Bank, or Arlabank, is the only Arab bank in the South at the inter-continental level for South America. Its objective is to promote financial co-operation between the Arab region and Latin America. Furthermore, Arlabank is participating in joint ventures in petrochemical industries and mining, besides financing trade between the two regions of the South.

(iii) Operating policies in developing countries, terms and conditions

As the Arab banks internationalized their networks and activities, they became involved with a wide spectrum of economic groups in the developed and developing countries. While penetration in the North was generally dictated

by micro-economic considerations, in the South it was based on longer-term macro-economic prospects[23/] and a desire for South-South co-operation.

The involvement of Arab banks with the developing countries took two forms: first, Arab banks have located in non-oil-producing developing countries to find profitable outlets on the spot; secondly, they started new and international activities with developing countries from their headquarters.[24/]

The national Arab banks' strategy in moving into non-oil-producing developing countries has been guided by a preference for non-oil-producing Arab countries, or for countries where they have long-established trade relations (e.g. Pakistan). International Arab commercial and investment banks wanted to complement their international networks by including the developing countries. Egypt has attracted by far the largest number, due to the size of its domestic market, its high absorptive capacity and its skilled labour force. Jordan has the second largest number. Tunisia now has the most defined national strategy to attract banks from the Gulf in the form of joint Tunisian ventures.[25/] The objective of these recently established banks is to channel commercial funds into investment projects, basically industry but also agriculture, to reach the target of 6 per cent annual growth of GNP and the creation of 300,000 new jobs during the Sixth Development Plan, 1982-1986.

In the rest of the developing countries, Pakistan is well placed thanks to its strong commercial ties with the Gulf countries. In Hong Kong, there are a relatively large number of Arab banks that participate in financing the industrialization of Southeast Asia's newly industrializing countries in order to link the Middle East with Asia's industrial power, Japan.

23/ Hazem El-Beblawi, "Oil Surplus Funds: the Impact of the Mode of Placement", OPEC Fund for International Development (Vienna, September 1981).

24/ Traute Wohlers-Scharf, "The Role of Petrocapital Banks in the Third World", presented at a meeting of the World Federation of Development Finance Institutions, Madrid, 1982.

25/ These joint Tunisian banking ventures are: Societé Tuniso-Séoudienne d'Investissement et de Développement (STUSID), established in 1981; Banque Tuniso-Koweitienne de Développement, established in 1981; Banque de Coopération du Maghreb Arabe, established in 1981; Banque Tuniso-Emirates d'Investissements, established in 1982; and Banque Tuniso-Qatari, established in 1982.

The general terms and conditions of Arab banks operating internationally are dictated by the market and the risk assessment of the fund-providers. For directly productive activities, such as industrial finance, the interest charges vary, with a spread of 2 per cent to 3 per cent over the London interbank offered rate (Libor), or are at market rates plus spread, or are determined on a case-by-case basis. The maturities range between 3 and 8 years, 5 and 7 years, 5 and 10 years, up to 7 years or 10 years, or they depend upon the project.

(iv) Sectoral allocation in project-lending

The investment of international Arab commercial banks and investment companies in project financing in developing countries has so far been modest. International trade finance and Euromarket operations were the core activities. Project financing by and large remained confined to the Arab region and concentrated on agro-industry, oil and related industries. Other areas of priority were real estate and tourism.

The alarming food deficit in the Arab region has made agro-industry a strategic sector for petro-capital investments. The Basic Programme for Agricultural Development in the Sudan, 1976 to 1985, comprises some 100 projects amounting to $6.5 billion. Projects range from infrastructure to farming, husbandry and agro-industries. The majority are to be financed by commercial as well as concessional funds.

Another ambitious project financed by governmental and private funds is the Kenana sugar complex, also located in the Sudan. Cost estimates for this agro-industry project escalated from $113 million in 1971 to more than $620 million when the complex was inaugurated in 1981. Major shareholders include the Governments of Sudan, Kuwait and Saudi Arabia and the Arab Investment Company (TAIC).

After the experience with Kenana, the Arab Investment Company (TAIC) has now shifted to smaller projects and plans to have greater control of the projects it finances than in the past by supervising schemes from inception to the operational stage. It now specializes in two areas: North Africa with

Tunisia, Mauritania and Morocco; and the Middle East with Jordan, Iraq and the Syrian Arab Republic.[26/]

Quite logically, the Arab oil-exporting countries began to develop a long-term interest in downstream oil activities in the mid-1970s. OAPEC took the initiative to create the Arab Petroleum Investment Corporation (APICORP) for such activities. It is active in loan syndication for oil-linked projects and has major interests in the Bahrain National Gas Company and the Jordan Fertilizer Company among others.

Another example is the Abu Dhabi Investment Company (ADIC), which is very active in the Euroloan and Eurobond markets for the benefit of projects in Arab countries in such sectors as oil, fertilizers and industry. It participated in $100 million loans to the Jordan Petroleum Refinery Company, the Qatar Steel Company and the Office Cherifien des Phosphates in Morocco.

Real estate, construction and tourism have traditionally been favoured by Arab investors. There are companies specializing in such activities, the most important being the Kuwait Real Estate and Investment Consortium (KREIC). KREIC operates primarily in Arab countries along the policy lines laid down by the Kuwait Government "to unify real-estate-investments and to strengthen local companies". In a short span of time, KREIC established a number of joint ventures with Arab host countries.

The most important of these joint companies are the Moroccan Kuwait Development Company, the Tunisian Kuwait Development Corporation, the Egyptian Kuwaiti Real Estate Development Company (KREDC), the Yemeni Real Estate Development Company, etc. KREDC also participates in such hotel chains as Syrian Arab Hotels and Tourism Company (with the Arab Investment Company (TAIC) and the Libyan Arab Foreign Bank) and the Saudi Hotels Services (again with TAIC, the National Commerical Bank and the Riyad Bank, all from Saudi Arabia).

26/ G. Watkins, "Sudan's Kenana Sugar Estate, An Example of Arab Co-operation", MEED, March 6, 1981, p. 36.

This concentration on the Arab region is understandable, for there is a natural complementarity between oil-exporting countries with low-absorptive capacity and the densely populated countries with high-development potential.

There are commercial investment activities of Arab banks and countries in other parts of the developing countries. The volume, sectoral allocation, problems and perspectives are, in the words of one author,27/ "terra incognita". Complementing the information on OPEC/Arab concessional flows into developing countries, an analytical survey of Arab commercial investments in developing countries could indicate modalities on how to link and mutually enhance both types of operations. This research remains to be done.

v) Major problems and perspectives

International Arab commercial banks and investment companies have only limited project-lending experience. In the past, one of the bottlenecks in the flow of commercial funds from one to the other was the lack of insurance coverage against non-commercial risks. A guarantee system, the Inter-Arab Investment Guarantee Corporation (IAIGC), was set up in 1975, and performs two complementary functions: guarantee coverage and project promotion. It is unique in that it can be considered "as the first operational model of international guarantee corporations in the contemporary world".28/

The Corporation also plans to promote trade between member states, provided that this involves goods produced, processed or manufactured in one of the member countries. A proposal to extend the IAIGC's mandate has recently been made to include export guarantees for Arab countries, as a supplement to Arab industrial finance for developing countries and to promote South-South trade co-operation.

27/ A. Al. Hamad.

28/ H.A. Sadeq, "The Inter-Arab Investment Guarantee Corporation, Finance and Industry", Industrial Bank of Kuwait, No. 2, 1981, p.19.

Another bottleneck in industrial project lending is the limited project identification and appraisal capacity of international Arab commercial banks. To remedy this they could use to good advantage the "umbrella" function of both Arab and Western aid agencies. Furthermore, project financing, particularly industrial, appears to be a better business proposition than providing balance-of-payments and general-support loans, as is presently being done. In addition, Arab international banks could use the information on potential investment possibilities provided by aid agencies, particularly in growth areas outside the Arab and Islamic countries.

At present, developing countries need massive transfers of capital, if only to maintain their economic levels of development. Moreover, the cost of development projects is bound to rise because of escalating equipment and construction costs and expensive technological innovations. A solution other than stepped-up aid will have to be found.

Arab business-oriented banks could be ideally suited to help finance real, direct investments on a large scale, which is possible only in developing countries.[29/] As the OPEC and Arab development funds have concentrated on financing infrastructure, the natural follow-up would be for Arab business-oriented banks to invest in the commercial components of development plans. Mixed and co-financing is already taking place, but there is considerable scope for more projects and programmes of this kind.

For the moment, only the OPEC and Arab aid agencies have set up a mechanism for co-ordinating their co-operation efforts. A similar framework could conceivably be established for commercial Arab banks to build up co-operation among themselves and with the Arab and Western aid agencies, which have already a fair amount of experience in developing countries. Ideally, Arab capital flows to developing countries should be seen as a whole: development and commercial capital should work together to maximize their financial impact on development.

At the summit meeting in Cancun in 1981, the Arab countries stated that they would participate in major efforts to help the developing countries by

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29/ See Ibrahim Shihata, The Other Face of OPEC (London, 1982), p.19.

matching Western assistance on a "dollar-for-dollar" basis. A similar scheme could be conceived to channel commercial capital into the developing countries. In this way, the concept of trilateral co-operation--already practiced successfully in development assistance--could be extended to business-oriented operations in developing countries.

D. ISLAMIC FINANCIAL INSTITUTIONS

i) The rise of Islamic economics and banking[30/]

Across the Islamic world there is a move to create Islamic financial institutions. This is but one manifestation of a broader phenomenon, the revival of Islam and its value system valid for 750 million people. The contribution of the Muslim world to a new international economic order could be based upon the application of the Shariah to modern economic and financial transactions.

The traits that distinguish Islamic economy and finance from their Western counterparts reflect a different understanding of the value of capital and labour. In lieu of a lender-borrower relationship, Islamic finance relies on equitable risk-sharing between the person who provides the capital and the entrepreneur. This practice derives from the central tenet of Islamic banking based on the Koran, which forbids the paying or charging of interest, i.e. "riba". This Arab term is assimilated to usury; this conceptual distinction has far-reaching consequences for project finance and investment in the economies of developing countries.

Islamic countries include both the world's richest and poorest developing countries. Therefore, financial intermediation between Islamic surplus and deficit countries is of prime importance to enhance the development process. Industrialization is essential for both types of countries, albeit with different connotations. For oil-exporting countries, diversification away from sole dependence upon petroleum is important; for non-oil producing

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30/ Traute Wohlers-Sharf, "The Role of Islamic Banking in Economic Development", Finance and Industry (The Industrial Bank of Kuwait, Kuwait,1982.)

Islamic countries, the industrial sector is one of the main driving forces for growth, employment creation and, possibly later, the earning of foreign exchange.

At present, some 20 Islamic financial institutions are in operation.[31/] This includes institutions with development and social mandates, on the one side, and commercial, investment and insurance (solidarity) companies, on the other. Whereas the former group was first established, today the second category is in full operation.

Besides the first attempt to establish Islamic banks in Pakistan in the 1940s, from 1963 to 1967 a pioneering experiment took place in Egypt in the form of rural savings banks in Mit-Ghamr in the Nile delta. The model of German savings banks was adapted to the rural environment of an Islamic developing country. The performance of these Islamic banks was impressive with respect to mobilizing capital. The experiment, however, did not last long enough to identify appropriate investment outlets on a large scale and was terminated basically for political reasons.

The majority of the population in Islamic countries--up to 90 per cent--have neither contacts nor dealings with Western-type financial institutions. Basically rural and religious, they tend to distrust banks operating according to occidental principles. Furthermore, there exist only few local branches which they can reach and patronize. Substantial parts of the income of the tradition-oriented population are allocated for social events and emergencies. If this idle capital could be mobilized for productive investments, it could give a new impetus to these economies without impairing the level of consumption. It is estimated that about $80 billion could be mobilized in the 55 Islamic countries, whereby $40 billion alone are alledgedly hoarded in the Middle East.

Islamic banks with development and social functions are the Nasser Social Bank and the Islamic Development Bank (IsDB). The first institution was established in 1971 to promote an insurance and pension system in Egypt. The

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31/ Cf. Annex II. Chronological Summary of Islamic Financial Institutions

inter-governmental IsDB, established in Jeddah in 1976, has now more than 40 Islamic countries as members. Its objective is to promote the economic and social progress of member countries and Islamic communities in non-member countries.

Commercial Islamic financial institutions comprise three different categories:

a) Banks operating in rural areas where they mobilize and use resources at the local level for productive purposes. The previously- mentioned savings banks in Mit-Ghamr belong to this category, as well as the most recently established Kibris Islamic Bank in Turkish Cyprus in 1982;

b) Banks located in the business centres of Islamic countries - such as conventional commercial banks - which are offering an Islamic alternative to the same type of clientele (e.g. Faisal Islamic Banks in Cairo and Khartoum, the Kuwait Finance House, the Dubai Islamic Bank and the Bahrain Islamic Bank);

c) International Islamic holding and investment companies, located in non-Muslim countries (e.g. Dar Al-Maal Al-Islami in Geneva and several Islamic financial institutions in London). (For details see Annex II);

d) The entirely Islamized banking system in Pakistan with specialized Islamic banks and interest-free departments (profit- and loss- sharing accounts--PLS) in all other nationalized banks. This is the first attempt toward a total Islamization process of the banking system of a country and is still being tested. Attempts to Islamize the banking system of Iran are also under way.

ii) Islamic instruments for industrial finance

In order to gain a better understanding of Islamic financial institutions and their possible operations in industry in developing countries, it is necessary to analyze the financial instruments at their disposal, both for the mobilization and utilization of funds.

The different Islamic financial institutions may mobilize funds from the general public, depending upon their major mandate, in the following forms:

a) Islamic banks may accept Islamic current and investment accounts. Current accounts are not remunerated. Clients benefit, however, from some banking services that are free of charge. Investment accounts permit clients to place funds in accounts for a selected time period (monthly, quarterly, etc.) and at a designated level of risk (minimum commercial risk, medium or high). Furthermore, Islamic banks provide a range of financial services on a fee basis.

b) Islamic investment companies offer to the general public participation in investment trusts ("moderaba") in the form of participation certificates ("soukouks"). The net profits are divided in a proportion of 9 to 1 in favour of the certificate bearers and the company, respectively. So far, 10 public "moderabas" have been launched and have generated substantial profits.

c) Islamic solidarity companies are the Islamic alternative to insurance. They offer to the general public solidarity trusts, i.e. "moderabas al-takafoul". The funds mobilized through these instruments are managed in a way similar to investment companies.

Given the two basic considerations, i.e. interest-free finance and equitable risk sharing, Islamic financial institutions may engage in the following activities:[32/]

a) Participation financing ("musharaka"): the bank provides part of the equity and working capital requirements of a project and shares with the entrepreneur(s) the profits or losses, if any.

b) Trust financing ("modaraba"): the bank provides all capital required, the client provides the management skill for a given project, again on a pre-detemined profit-sharing basis. Losses have to be borne by the bank alone, clients lose the value of their work.

32/ Prince Mohammad Al-Faisal Al-Saud, "The emergence and prospects of Islamic banking in the 1980s", paper prepared for the Conference on Arab Banking andd Finance, organized by the Arab Bankers Association, London, 7 and 8 June 1982.

c) Cost-plus trade financing ("mourabaha"): the financial institution purchases raw materials, goods and equipment at cost and sells them to clients on a cost-plus negotiated profit-margin basis.

d) Rental financing ("ijara"): the bank acquires equipment or buildings and makes them available to clients on a straight-forward rental basis.

e) Lease-purchase financing ("ijara wa iktina"): the legal construction is similar to the above, only clients have the possibility of acquiring ownership of the rented equipment or buildings by paying instalments into savings accounts. The re-investment of this accumulated capital works in favour of clients, allowing them to offset rental costs.

Other activities of Islamic financial institutions include traditional Western-type banking services on a fee basis, the identification of external markets and outlets for affiliated enterprises, the provision of information necessary for business expansion and the provision of general economic, financial and technological intelligence for customers and the Islamic community. Islamic financial institutions can also provide interest-free loans for important development projects and social objectives. Furthermore, the types of activities can be combined in various forms to cope with the finance requirements of modern economies.

iii) Operating policies and activities in the industrial sector

The IsDB may provide participation in equity loans for economic and social infrastructure projects in the public and the private sector. Furthermore, the bank may operate special funds, promote foreign trade and provide technical assistance.

The policies of IsDB reflect the trend to maintain a balance between equity investment in developing countries and loans extended to these countries. In recent operations about two-thirds of project financing has been in the form of equity participation. Priority is given to projects that involve joint ventures, or that are of regional character and thus likely to benefit more than one recipient country.

Most of IsDB's finance is allocated to the foreign exchange component of its operations; in the case of the developing countries, however, local currency components are also covered by its loans. IsDB's equity participation have focussed on relatively high yielding projects in developing countries. In such operations IsDB requires guarantees from the government or from the central bank of the recipient country.

The relatively high amounts of finance allocated to foreign trade resulted from IsDB's policy of utilizing funds not immediately needed for current operations and from channelling short-term funds for development purposes within member-countries. Initially, unused funds were deposited with the Saudi Monetary Agency (SAMA) for investment in short-term deposits, with returns being kept in a special account until other investment opportunities consistent with Shariah were identified. In recent years, IsDB decided to reallocate the unused funds for the short-term financing of foreign trade, particularly among the member countries of the IsDB, which also helped the balance-of-payments position of these economies.

About $200 million was allocated to equity participation in some 140 projects. These include fertilizer projects in Senegal, a synthetic fibre plant in Pakistan, a poultry project in the Yemen Arab Republic, and a paper pulp mill in the United Republic of Cameroon. In the case of projects which require small investment amounts, IsDB has extended lines of equity to national development banks for direct "sub-investing". This form of assistance was extended to development finance institutions in Nigeria, Turkey, Somalia, Pakistan, Jordan, Tunisia and Bangladesh.

Leasing activities have been one major innovation of the IsDB. The bank purchases the capital goods which it then leases to the relevant enterprise for an agreed service charge. At the end of the agreed period, the goods are sold to the recipient country. Leasing by the IsDB has ranged from railway wagons, locomotives and ships to tractor factories, jet and port-handling equipment. The total amount committed to leasing has reached about $190 million.

Since the IsDB is precluded from charging interest on its operations, its major source of earnings has been the investment in projects and enterprises

through leasing and equity participation. The lending terms for infrastructure projects include only a small service fee for administrative expenses, below 1 per cent, repayment periods for 40 years and grace periods for 10 years.

The second multilaterial Islamic financial institution is the Dar Al-Maal Al-Islami (DMI), established in 1981 with a targeted capitalization of $1 billion. The main objectives of DMI are to undertake all financial operations required by Muslims today in the framework of the precepts of Shariah and to implement its various activities through subsidiaries to be established in Islamic and other countries. The expansion plan foresees the establishment of 28 Islamic banks, 26 Islamic investment companies, 20 solidarity (insurance) companies as well as Islamic business development companies. The Islamic banks should be capitalized with between $20 million and $50 million, with DMI holding 51 per cent and the balance with local partners.

DMI's first investment project in developing countries is the rain-fed Damazin project in the Blue Nile province of Sudan. By 1984, the project is scheduled to cover over 200,000 hectares with maize, sesame, cotton, and the like. Capitalized at $58 million, the project also received finance from the IsDB.

The warm welcome given DMI in Africa can be explained by the Bank's avowed aim to become involved in the host country's economy by providing project financing. Thus in Guinea, DMI plans to take a major part in the financing of a $100 million oil refinery with an annual capacity of 1 million tons. In Gabon, two projects have been identified, the construction of 300 villas for officials on a lease-purchase basis and the local baby-food factories.

Next on the target list of DMI are Mali, the Ivory Coast, Benin and Togo. DMI has decided to concentrate in future on those countries where the operating environment is receptive to the Islamic financial system.

iv) Major problems, co-operation possibilities and perspectives

Islamic financial institutions concentrated in their formative years on mobilizing rather than on deploying funds. The identification of profitable investment opportunities, appraisal and follow-up of projects in great numbers will be the major challenge of these institutions in the future, given that they are just starting to recruit professionals with this expertise.

Within a few years, Islamic institutions attracted large amounts of savings from the Muslim population, money that was otherwise held outside the monetary circuits. The utilization of capital for profit- and loss-sharing schemes and other "halal" (licit, according to and compatible with the Shariah) instruments reconciled the values of large segments of the Muslim population with modern banking practices and international finance.

Islamic banking is based upon quite different concepts from those of occidental banks. Therefore innovative and novel approaches to co-operation are required. The full implications of Islamic banks operating in co-existence with occidental finance intermediaries have yet to be analyzed at the conceptual level. Islamic financial instruments are often conceived without acknowledging the fact that a well entrenched Western banking system is already in existence in all the countries in which they are located.

Co-operation with Islamic banks has two aspects: co-operation between Islamic banks operating in monolithic and mixed economic systems (e.g. Pakistan and Kuwait), and co-operation with occidental banks operating in economic systems based entirely on the occidental concept of interest. At the operational level this coexistence works in several countries (e.g. Egypt and Sudan.). It is felt that increased competition will be compensated for by an expansion of the banking public both in terms of mobilization and allocation of finance, and that Islamic banks will provide new, socially-desirable services.[33/]

33/ Roger Cooper, "A Calculator in one Hand and the Koran in the Other", Euromoney, Nov. 1981, p. 144.

So far an experiment of co-operation between Islamic and occidental banking at operational level exists in the form of co-financing operations of the IsDB.[34/] The Bank's partners have been multinational and national Arab development funds and Arab investment companies, but also important international banking institutions from OECD countries. The areas of co-operation that will be strenghtened are the provision of lines of equity (the IsDB has already opened lines of equity in 12 national development banks in 11 countries), co-financing with other investment banks and joint ventures in developing countries.[35/]

Islamic banking was conceived under the assumption of operating in an interest-free environment. Since Islamic banks started to operate in economies based upon interest financing, the forms of co-operation, but also of competition have yet to evolve. The following tendencies might be considered: Islamic banks could combine their experience in trade financing with investment activities beyond national boundaries. However, the identification of suitable partners requires considerable expertise in the countries and markets in which the investments are proposed.

Islamic banks could concentrate on specific groups of entrepreneurs, e.g. small- and medium-sized innovative enterprises. They often have difficulties in mobilizing for expansion and innovation, due to the lack of securities and international market connections to sell their products. Conventional banks in general prefer other outlets. Furthermore, Islamic banks could be more attractive to an entrepreneur than conventional banks, because there is no fixed interest burden and the profit is shared according to the contract. Ultimately, such operations could be advantageous for Islamic banks, their home countries and innovative entrepreneurs, even beyond profitability, in that they could promote economic co-operation at the micro-economic level in a personalized and tailor-made style.

34/ Islamic Development Bank, Co-financing: the IsDB's Experience, Internal document.

35/ Azizur Rahman, A.N.M., "Co-operation between financial institutions in Member countries to finance trade and to support local Islamic banks: the role of IDB", Journal of Economic Co-operation among Islamic countries, January, 1982.

Islamic banks could make a useful contribution to economic growth and development, particularly in the present situation of recession, stagflation and zero-growth levels, because the core of their operations should be oriented towards productive investments. At present, all economies need more venture capital. Loan capital is available, but at too high interest rates to finance expansion and innovation. This has acted as a brake on productivity and economic growth. Thus, practical and immediate co-operation possibilities exist between Islamic banks and industrial enterprises all over the world. The intermediation process remains to be fully developed.

Part IV Recent proposals and recommendations for augmenting the flow of industrial finance

The economies of the developing countries have been hit particularly hard by the present world economic recession. Their need for external finance is increasing, but both ODA and commercial flows have had a downward trend.

So far, aid agencies in the South have co-operated with commercially-oriented sources to a limited extent (with the exception of the IDB). Some other multilateral aid agencies have already acquired extensive experience in co-financing with international commercial sources for the benefit of developing countries. In particular the World Bank group has recognized the potential in this area and will expand its co-operation with commercial banks in scope and scale.[36/] The underlying philosphy is not only to play a catalytic role in arranging financing from different sources for developing countries, but also to introduce elements of competitiveness and increased efficiency in the use of funds by working with commercially-oriented partners.[37/]

The purpose of the IFC, an affilate of the World Bank Group, is to encourage commercial enterprises in the developing countries. At present, IFC is also set for operational expansion. Its future activities will not only take place in the newly industrialized countries, but also in the developing countries. There, commercially-oriented enterprises have a major role to play in supporting and accelerating development. IFC intends to expand its activities in Sub-Sahara Africa and thus mobilize additional funds and expertise for this region from international investment partners.

36/ Annex III, The World Bank's Co-financing Programme with Commercial Banks.

37/ A.W. Clausen, The World Bank and International Commercial Banks, Partners for Development (Vancouver, May 1982).

Aid agencies in developing countries voiced their emerging interests to assess the advantages and potential pitfalls in combining both concessional and commercial sources during a recent meeting of OPEC/Arab and DAC donor agencies.[38] The following recommendations were made on how donor agencies, in general, could be instrumental in increasing non-concessional flows to developing countries:[39]

- The donor agency as a financial intermediary: intermediation between international financial markets and developing countries is possible only when the agency is empowered by its statutes to resort to international borrowing. Some institutions with this possibility, particularly those from the developing countries, have yet to start to play this role. Another line of action may be to increase the capital base and change the statutory lending authority (gearing ratio) of certain aid agencies. In the 1980s financial intermediation will become more prominent for institutions in developing countries, because direct and bilateral access to capital markets will become more expensive, if not more difficult, for individual developing countries.

- The donor agency as a co-lender with commercial sources: the success of donor agencies in co-financing projects among themselves is yet to be matched by a similar level of co-operation with commercial sources. One basic constraint is the preference for general budget loans when borrowing from commercial sources. There are a growing number of cases of mixed financing when projects can be structured to accommodate both types of funding, e.g. by isolating the infrastructure component from the cash-generating part. Donor agencies could use their advantageous access to reliable information on the borrowers, capacity for project

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38/ Meeting of OPEC/Arab - DAC Donor Agencies with the participation of Multilateral Financial Institutions and Commercial Banks, held in Vienna, hosted by the OPEC Fund, May 30-31, 1983.

39/ See Ibrahim Shihata, "The role of donor-agencies in non-concessional transfers to LDCs", OPEC Review, Vol.VI, No.3, 1982.

appraisal and acceptability by recipient governments more systematically for attracting greater volumes of non-concessional funds for projects in developing countries.

- The donor agency as catalyst in foreign direct investments: by providing equity participation and loans for projects appraised by it, the donor agency can directly, or through the intermediation of local development institutions, play a catalytic role in stimulating and attracting additional risk capital from other sources. Thus, the Kuwait Fund, which is now empowered to equity financing, could encourage Arab commercial banks and investment companies to increase their level of direct investments in developing countries. The Islamic Development Bank could also step up its provision of equity, beyond lines of equity, to local development banks.

- The donor agency as advisor and source of technical assistance in tapping financial markets: the expertise of donor agencies should be made available to interested developing countries in putting together financial packages attractive to foreign investors. This may include information of foreign sources of finance, revising investment codes, tapping international markets and improving the efficiency of local institutions, instruments and legislation.

- The donor agency as a promotor of investment institutions: public development finance institutions can take the lead in sponsoring the establishment of investment companies, financing new real investments in developing countries, to implementing such investments or providing them with insurance against non-commercial risks. The Kuwait Funds initiative in the creation of the Inter-Arab Investment Guarantee Corporation is a case in point. New initiatives could include the creation of multilateral insurance guarantee schemes, along with the establishment of new multilateral investment corporations that would aim at making profits through direct investments in developing countries for development purposes. The characteristic feature would be to make profits from its overall activities and not necessarily from each project and to distribute dividends to its shareholders.

During the discussions of the above-mentioned OPEC/Arab-DAC aid agencies meeting, the following actions were suggested:

- Stepped-up identification by aid agencies of projects appropriate for co-financing with commercially-oriented banks;

- Encourage governmental authorities to give favourable classification to co-financed assets;

- Seek more favourable tax treatment for losses arising from co-financed projects;

- Consider subordination of concessional loans under certain conditions to those of commercial banks;

- Offer attractive low-premium insurance of exchange rate and other risks to co-lenders. (This is particularly important in the case of bilateral donor agencies with limited umbrella capacities.)

- Directly encourage the establishment and rehabilitation of productive enterprises, e.g. through pre-investment and feasibility studies, political risk insurance and guarantees;

- Provide indirect support to encourage the establishment and rehabilitation of small- and medium-sized productive enterprises through advisory, technical and capital assistance to strengthen intermediary funding institutions, export promotion schemes, market analysis, etc.

Activities in this direction will bring about a more constructive operations relationship between aid agencies and international commercially-oriented banks. The latter are, in the case of Arab shareholders, almost exclusively public institutions. Exchange of views, information and experience on debt, trade and other critical performance indicators between these two groups of fund providers could lead to joint and mutually beneficial actions.

Furthermore, international lending to developing countries should become more project-related. Closer co-operation between public donor agencies--with their project appraisal-capacity and other fund providers--, could promote additional asset-creation in developing countries.

Venture capital operations could be another area of expansion. This field is rather untested, as far as developing countries are concerned. Demand for venture capital is abundant. Islamic banks which have increased their capacity in fund mobilization in the last few years, are now looking for outlets for profitable schemes. They could be promising partners for this new activity.

The proposal of a South Bank, discussed at the recent UNCTAD meeting in Belgrade in June 1983, includes an array of activities that are either neglected or insufficiently supported by the existing institutions. The proposed bank's functions would cover, inter alia, financing of joint ventures, project financing, particularly in resource development and processing, export credit, balance-of-payments support by programme lending, etc. There exists also a proposal for a commercial bank in the South, suggested by the President of the Bank of Credit and Commerce International (BCCI).

The various recommendations reflect the need to augment the flow of funds into developing countries and to employ the funds more in accordance with the perceived objectives of the developing countries. This will require novel and creative approaches, or a new combination of existing techniques. The scarcities of the 1980s will necessitate an adequate response to the challenge of the present international economic crisis.

ANNEX I

MAJOR OPEC/ARAB BANKS AND FUNDS

Name of Institution	Year of establishment	Location	Total Assets 1980; million US-dollars
A. Arab International-Oriented Financial Institutions			
National Commercial Institutions			
Arab Bank	1930	Amman	4 830
National Commercial Bank	1938	Jeddah	9 300
Rafidain Bank	1941	Baghdad	11 720
Riyad Bank	1957	Jeddah	7 270
Gulf Bank	1960	Kuwait	4 310
United Bank of Kuwait	1966	London	1 110
National Bank of Abu Dhabi	1968	Abu Dhabi	4 740
Libyan Arab Foreign Bank (LAFB)	1972	Tripoli	1 920
Burgan Bank	1975	Kuwait	1 510
Al-Saudi Banque	1976	Paris	816
Bank of Oman	1976	Dubai	1 080
Union Bank of the Middle East	1977	Dubai	721
Arab-Occidental Consortium Banks			
FRAB Bank International	1969	Paris	1 010
Union des Banques Arabes et Francaises (UBAF)	1970	Paris	5 010
European Arab Holding	1972	Luxemburg	1 960
Bank of Credit and Commerce International (BCCI)	1972	Luxemburg	5 340
Banque Arabe et Internationale d'Investissement (BAII)	1973	Paris	1 530
Saudi International Bank	1975	London	1 930
Banco Arabe Español	1975	Madrid	1 370
Arab Latin-American Bank (ARLABANK)*	1977	Lima/Manama	1 500
Arab Hellenic Bank	1979	Athens	39
Inter-Arab Joint Ventures			
Arab African Int. Bank	1964	Cairo	2 220
Arab International Bank	1971	Cairo	1 530
Arab Bank for Investment and Foreign Trade (ABIFT)	1975	Abu Dhabi	680
Gulf International Bank (GIB)	1975	Manama (Bahrain)	2 900
Arab Banking Corporation (ABC)	1980	Manama (Bahrain)	1 920

* Arab Latin-American consortium bank.

MAJOR OPEC/ARAB BANKS AND FUNDS

Name of Institution	Year of establishment	Location	Total Assets 1980; million US-Dollars
National Investment Banks			
Kuwait Investment Co. (KIC) Kuwait Foreign Trading Contracting (KFTCIC) Kuwait International Investment Company (KIIC)	1961	Kuwait	848
	1973	Kuwait	520
Abu Dhabi Investment Co. (ADIC)	1977	Aby Dhabi	520
Inter-Arab Investment Banks			
The Arab Investment Co. (TAIC)	1974	Riyadh	440
Arab Petroleum Investsment Corporation (APICORP)	1975	Dhahran	425

B. Arab and OPEC Development Funds

			Authorized capital 1981; million US-Dollars
National Institutions			
Kuwait Fund for Arab Economic Development	1961	Kuwait	7 400
Aby Dhabi Fund for Arab Economic Development	1971	Aby Dhabi	516
Saudi Fund for Development	1974	Riyadh	7 500
Multilateral Arab Institutions			
Arab Fund for Economic and Social Development (AFESD)	1972	Kuwait	1 830
Arab Bank for Economic Development in Africa (BADFA)	1975	Khartoum	742
Arab Gulf Fund for United Nations Development (AGFUND)	1981	Bahrain	200
International Institutions			
Islamic Development Bank	1975	Jeddah	2 400
OPEC Fund for International Development	1976	Vienna	4 000

Data base: "The Top 100 Arab Banks", The Banker, December 1981; MEED, Middle East Financial Directory 1981; Annual Reports.

ANNEX II

Chronological Summary of Islamic Financial Institutions

Name of Institution	Year of establishment	Location	Capital $ million (1981)
		Arab Region	
Nasser Social Bank	1971	Cairo	Authorized and Paid-in: 14.3 Loans: 330
Dubai Islamic Bank	1975	Deira	Authorized and Paid-in 13.6 Total assets: 278
Faisal Islamic Bank of Egypt	1977	Cairo	Authorized: 40 Paid-in 21.2 Total assets: 589
Faisal Islamic Bank of Sudan	1977	Khartoum	Authorized: 20 Paid-in 9.0 Total assets: 135
Kuwait Finance House	1977	Kuwait	Authorized: 36 Paid-in 9.0 Total assets: 620
Jordan Islamic Band for Finance and Investment	1978	Amman	Authorized: 13.8 Paid-in 6.5 Total assets: 49
Bahrain Islamic Bank	1979	Manama	Authorized: 61 Paid-in 15.3
Islamic International Bank for Investment and Development	1980	Cairo	Authorized and Paid-in: 12
Bahrain Islamic Investment Company	1981	Manama	Authorized and Paid-in: 13
Islamic Investment House	1981	Amman	Authorized: 12 Paid-in: 6
		Other Muslim Countries	
Iranian Islamic Bank	1979	Teheran	Paid-in: 115

Continued

Islamation of entire banking system	From 1979 To 1982	Pakistan	-
Islamic International Bank Bank of Bangladesh	1982	Dacca	Authorized: 30.8 Paid-in: 10
Bank Islam Malaysia	1983	Kuala Lumpur	
		Other Countries	
Philippine Amanah Bank	1974	Zamboanga City	Paid-in: 5.8 Total assets: 28
First Muslim Interestfree	1976	Johannesburg (South Africa)	-
Islamic Investment Company	1977	Nassau	Paid-in: 2.0
Islamic Banking System Holding	1978	Luxemburg	-
Al-Rajhi Company for Islamic Investment	1980	London	Paid-in: 0.2
Shariah Investment Services	1980	Geneva	-
Islamic Finance House	1980	London	-
Dar Al-Maal Al-Islami	1981	Geneva	Authorized: 1000 Paid-in: 350
Islamic Investment Company	1982	London	Paid-in: 5.0
Kibris Islamic Bank	1982	Lefkosa/ Nikosia, Cyprus	Authorized: 5.0 Paid-in: 1.0
Islamic Investment Company	Under establishment	Melbourne	-

Data base: Annual Reports, Specialized Journals (e.g. Arabia, The Islamic World Review).

ANNEX III

The World Bank's Co-Financing Programme with Commercial Banks[1/]

Co-financing by the World Bank, directly associates its funds with those provided by other sources in financing specific projects or programmes in developing countries. The main categories of co-financing partners are: (a) official sources; (b) export credit institutions; and (c) private financial institutions, primarily commercial banks.

World Bank co-financing operations have risen steadily during the past decade with the number of operations increasing from 37 in fiscal year 1973 to 99 in fiscal year 1982. During the same period, the total volume of co-financing rose from $496 million in fiscal 1973 to a record $7.4 billion in fiscal 1982. Of this $7.4 billion, co-financing with private financial institutions comprises $3.3 billion, export credit agencies account for about $2.0 billion and another $2.1 billion will come from official sources. (See Table 2 for co-financing by source for the entire 1973-82 period).

Forty per cent (99 of 247) of the projects approved by the World Bank in fiscal 1982 involved some co-financing. The funds to be provided by co-lenders are equivalent to 57 per cent of the total amount ($ 13 billion) lent by the World Bank for all projects.

World Bank co-financing operations with private sources have experienced a substantial increase in recent years. The volume has grown from $84.7 million in fiscal 1974 to $3.3 billion in fiscal 1982, and the number of operations with potential for co-financing from private sources has increased from 2 in 1974 to 16 in 1982.

1/ Source: World Bank, "Background paper on Co-financing with Commercial Banks", Meeting of OPEC/Arab-DAC Donor Agencies with the participation of Multilateral Financial Institutions and Commerical Banks, Vienna, May 30 and 31, 1983, organized by the OPEC Fund for International Development.

In typical co-financing operations, the IBRD and the commercial banks have entered into separate loan agreements with the borrower. The commercial loans are on market terms and are negotiated directly by the co-financier with the borrower. They are linked to the IBRD loan through an optional cross-default clause and a memorandum of agreement signed by the IBRD and the agent for the commercial banks. The memorandum of agreement provides for the exchange of information on the project, and serves to keep the World Bank and the co-lender in contact during the implementation of the project. Not all co-financing have formal links to the World Bank through cross-default arrangements. Some lenders wish to negotiate the terms and conditions of their loan agreement directly with the borrower exclusive of World Bank involvement.

A total of 207 private banks participated in co-financing operations involving formal arrangements during fiscal years 1974-82. These banks provided about $2.0 billion worth of funds. (See Table 1 for a complete listing). An additional $1. 7 billion has been arranged in conjunction with World Bank projects, but without formal links to the World Bank loan. Another $4.8 billion in private co-financing is envisaged, but yet to be arranged, for World Bank projects that have already been approved. Table 3 gives the sectoral breakdown of co-financing operations.

The World Bank has recently held extensive discussions with its borrowers and with representative banks from major countries on how to improve its co-financing operations to attract co-financing and provide increased benefits. These discussions have suggested that the World Bank could participate directly in syndicated project loans.

In such an operation, sometimes referred to as the "B" loan technique, the IBRD would in some manner be directly involved in a commercial co-financing loan. This commercial co-financing loan (referred to as the "B" loan) would be used to provide additional financing to projects for which the Bank is providing financing through a standard IBRD loan (referred to as the "A" loan). The borrower would enter into separate loan agreements for the "A" and "B" loans. The terms and conditions of lending for the "A" loan would be standard IBRD terms, while the "B" loan would be based on commercial terms of lending.

There are various ways in which the World Bank's participation in a syndicated project loan could be structured. The World Bank might fund the later maturities on loans or, alternatively, guarantee or accept the contingent financing obligations for them. The precise structuring of a co-financing operation would have to be individually structured in consultation with the borrower and co-lenders, considering such factors as the nature of the project and the standing of the borrower in the market.

Table 1. Summary of private bank participation in co-financing of World Bank supported projects, by country of headquarters

Ownership	Number of Institutions	Co-financing Amount	Total private co-financing
Australia	2	7.0	.3
Austria	6	22.5	1.1
Belgium	5	32.8	1.6
Brazil	3	9.0	.4
Canada	9	142.7	7.1
Consortium Banks, Arab	11	43.1	2.2
Consortium Banks, Other	23	98.8	4.9
Federal Republic of Germany	13	94.0	4.7
France	4	85.0	4.3
India	2	24.0	1.2
Italy	5	19.0	1.0
Japan	35 a/	596.1 a/	29.8
Jordan	1	10.0	.5
Kuwait	3	15.0	.8
Luxembourg	3	11.0	.6
The Netherlands	7	87.3	4.4
Sweden	1	8.6	.4
Switzerland	9	36.0	1.8
The United Kingdom	13	163.3	8.2
The United States	39	448.5	22.5
Other	13	43.3	2.2
Total: Number of operations	207	1,997.0	100.0

a/ Figures include 3 Yen loans totalling US$155 million equivalent which are under negotiation; participating banks are not yet known.

Note: Figures do not include information on around 48 projects totalling around US$6.5 billion in private co-financing without formal arrangements with the World Bank and co-financing operations which are envisaged but yet to be arranged.

Private Co-financing in World Bank Projects Approved by the Board	US$ Billion
Involving special arrangements	2.0
Arrangrd with no formal link (estimate)	1.7
To be arranged	4.8
Total (FY74-82)	8.5

Table 2. World Bank co-financing operations by source, FY73-82
(US$ million)

Fiscal Year	Projects with co-financing		Source of Co-financing						Bank Group contribution		Total Project Cost
			Official		Export credit		Private				
	No.	Amount	No.	Amount	No.	Amount	No.	Amount	IBRD	IDA	
73	37	$ 496.2	30	$ 313.0	10	$ 183.2			$ 478.9	$ 308.0	$ 2,813.1
74	48	1,463.0	44	788.8	11	589.5	2	$ 84.7	1,092.6	184.3	5,416.0
75	53	1,940.3	48	923.3	9	962.0	1	55.0	1,033.6	346.1	8,817.7
76	73	2,255.1	61	1,079.7	16	902.9	5	272.5	1,583.3	403.1	9,620.3
77	81	2,292.1	72	1,544.7	9	197.5	9	549.9	1,866.2	698.0	9,920.1
78	81	2,458.7	71	1,757.2	16	539.3	6	162.2	1,678.5	762.3	11,299.9
79	109	3,148.9	88	1,975.8	16	659.2	13	513.9	2,993.3	1,146.2	14,005.8
80	92	6,513.7	68	2,458.6	23	2,282.3	20	1,712.9	3,157.9	1,605.2	21,445.4
81	81	4,141.8	67	1,598.5	8	737.1	18	1,806.2	3,230.9	1,477.1	21,542.6
82	99	7,423.7	76	2,102.5	26	2,068.5	16	3,252.7 a/	4,433.4	1,299.9	24,773.1
Total	754	$32,133.5	625	$14,542.1	143	$9,121.6	92	$8,470.0	$21,548.6	$8,230.2	$129,683.6

a/ Figures include US$500 million in private co-financing for which specific projects have yet to be identified.

Note: The number of individual operations with co-financing by source is greater than the total amount since there are projects co-financed from more than one source.

Table 3. World Bank co-financing operations by sector, FY73-82
(US$ million)

Sector	Projects with co-financing No.	Projects with co-financing Amount	Source of Co-financing: Official No.	Official Amount	Export credit No.	Export credit Amount	Private No.	Private Amount	Bank Group contribution IBRD	Bank Group contribution IDA	Total Project Cost
Agric.& rural development	246	$ 4,638.3	226	$ 2,969.8	7	$ 98.9	17	$ 1,569.7	$ 3,193.9	$3,348.4	$21,102.5
WFC	18	907.9	10	60.8	2	167.0	9	680.0	1,019.3	51.6	2,846.6
Education	43	171.9	43	171.6	1	0.3			379.8	379.8	1,372.1
Oil, gas & coal	21	3,503.7	11	366.3	11	1,159.7	9	1,977.5	1,610.5	189.0	7,844.7
Power	108	10,183.9	80	4,500.1	43	3,455.9	28	2,228.0	6,265.1	1,379.0	38,064.2
Industry	58	5,009.7	39	2,242.2	24	1,768.8	14	998.7	2,927.9	673.5	21,338.4
Program lending & SAL	8	120.1	8	120.1					60.0	291.5	471.4
Pop. health & nutrition	10	161.1	10	161.1					36.8	144.9	487.4
Small scale industry	13	305.8	12	217.8	4	80.0			384.0	14.5	1,562.7
Technical assistance	10	14.3	10	14.3					13.8	29.8	75.4
Telecommunications	28	861.8	17	332.3	18	479.5	2	70.0	839.9	286.5	4,172.4
Tourism	5	83.0	3	38.4	1	9.6	2	35.0	92.7	4.0	721.2
Transportation	140	5,296.8	114	2,579.4	30	1,878.5	9	839.0	3,934.4	1,060.2	25,897.8
Urbanization	8	104.6	7	34.5			1	70.0	157.5	94.0	610.4
Water supply & beverage	38	750.6	35	733.3	2	15.4	1	1.9	694.9	283.8	3,151.0
Total	754	$32,133.5	625	$14,542.1	143	$9,121.5	92	$ 8,470.0a/	$21,548.6	$8,230.2	$129,683.6

a/ Figures include US$500 million in private co-financing for which specific projects have yet to be identified.

Note: The number of individual operations with co-financing by source is greater than the total amount since there are projects co-financed from more than one source.

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